

Message Text

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ACTION EUR-25

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SUBJECT: DISCOUNT RATE INCREASED AND ISSUE TERMS FOR TREASURY
BILL CHANGED

REF: (A) ROME 7413 OF DEC 5, 1972; (B) ROME 5593 OF JUNE 19,
1973; (C) ROME 7482 OF JULY 27, 1973

1. SUMMARY: FOUR TREASURY MINISTRY DECREES DATED SEPTEMBER 14 (A)
RAISE BANK OF ITALY DISCOUNT RATE AND RATES ON ADVANCES, (B) REDUCE
MATURITY OF TREASURY BILLS TO BE ISSUED DURING REMAINDER OF
1973 FROM ONE YEAR TO SIX MONTHS AND (C) FIX GROSS TREASURY
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BILL ISSUES FOR SEPTEMBER AND OCTOBER AT TOTAL OF 1300
BILLION LIRE. DECREES CONSITITUTE LATEST MEASURES IN CENTER-
LEFT GOVERNMENT'S ANTI-INFLATION PROGRAM. END SUMMARY.

2. MEASURES CONTAINED IN FOUR DECREES: (A) RAISE BASIC DISCOUNT RATE OF BANK OF ITALY EFFECTIVE SEPTEMBER 17 FROM 4.00 PERCENT TO 6.50 PERCENT. ADDITIONAL PENALTY RATE IS RAISED FROM 1.50 PERCENT TO 3.00 PERCENT, FOR MAXIMUM OF 9.50 PERCENT. PENALTY RATE APPLIES TO BANKS WHICH USED DISCOUNT FACILITY DURING PREVIOUS SIX CALENDAR MONTHS IN EXCESS OF 5 PERCENT OF THEIR REQUIRED RESERVES; (B) RAISE INTEREST RATE ON ORDINARY BOI ADVANCES ON CURRENT ACCOUNT FROM 3.50 PERCENT TO 6.50 PERCENT AND ON FIXED TERM "LOMBARD" ADVANCES (8, 15 AND 22 DAYS) FROM 5.50 PERCENT TO 6.50 PERCENT. PENALTY RATE ON FIXED TERM ADVANCES REMAINS UNCHANGED AT MAXIMUM OF 3.0 PERCENT. IT CONTINUES TO BE ASSESSED IN THREE STAGES AS DESCRIBED IN REF (B). (ALTHOUGH NO PENALTY RATE APPLIES TO ADVANCES ON CURRENT ACCOUNT, BOI EXERCISES MORE DIRECT CONTROL OVER AVAILABILITY OF THIS TYPE OF CREDIT.) (C) FIX MATURITIES FOR ORDINARY TREASURY BILLS (BOT'S) ISSUED FOR FREE INVESTMENT PURPOSES DURING MONTHS OF SEPTEMBER TO DECEMBER 1973, INCLUSIVE, AT SIX MONTHS (INSTEAD OF FORMER ONE-YEAR MATURITY); (D) ESTABLISH THE AMOUNT OF SUCH BOT'S TO BE ISSUED IN SEPTEMBER 1973 AT 800 BILLION LIRE, ALL OF WHICH WILL INITIALLY BE SOLD TO BANK OF ITALY FOR SUBSEQUENT RESALE, WITH COUPON OF 9 PERCENT, NOMINAL PRICE OF 95.50. FOR YIELD ON DISCOUNT BASIS OF 9.64 PERCENT; AND (E) ESTABLISH AMOUNT OF SUCH BOT'S TO BE ISSUED IN OCTOBER 1973 AT 500 BILLION LIRE WITH SAME TERMS OF ISSUE BUT ALL TO BE SOLD IN MARKET. (SINCE 400 BILLION LIRE IN SUCH BOT'S TO BE REDEEMED IN SEPTEMBER, NET AMOUNT OF THESE ISSUES IN TWO-MONTH PERIOD WILL BE 900 BILLION LIRE.)

3. IN AFTERMATH OF NEW CREDIT MEASURES 14 - BANK CARTEL REPORTEDLY PLANS TO MEET SEPTEMBER 21 TO SEEK AGREEMENT ON INCREASES IN INTEREST RATES CHARGED THEIR CLIENTS AND ON PLAN TO HOLD LINE ON INTEREST RATES PAID ON DEPOSITS. PROPOSAL IS FOR 10.00 PERCENT RATE ON OVERDRAFTS, 9.75 PERCENT ON DISCOUNTS AGAINST SECURITIES AND 9.50 PERCENT ON GUARANTEED DISCOUNTS. MAXIMUM INTEREST RATES PAID ON LARGE DEPOSITS WOULD REMAIN AT 7 TO 7.25 PERCENT LEVEL. AT SAME TIME INTERBANK RATE, LIMITED OFFICIAL USE
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WHICH TENDS TO FOLLOW RATE ON FIXED GERM BOI ADVANCES, WOULD BE EXPECTED TO APPROACH 9.50 PERCENT.

4. LATEST PACKAGE OF CREDIT MEASURES (SEE ALSO REFS B AND C) ARE DESCRIBED AS AIMED AT FACILITATING FINANCING OF LARGE TREASURY CASH DEFICIT, AT UPDATING COST OF CENTRAL BANK CREDIT IN ORDER TO REFLECT CURRENT CREDIT MARKET CONDITIONS AND AT REDUCING INCENTIVE TO CAPITAL OUTFLOWS FROM ITALY DUE TO INTEREST RATE DIFFERENTIALS. (JULY ISSUE OF NORMAL ONE-YEAR BOT'S WITH YIELD OF ONLY 7.35 PERCENT DID NOT SELL WELL BECAUSE OF UNATTRACTIVE TERMS. HIGHER YIELD ON NEW ISSUES SHOULD BE

MORE ATTRACTIVE AND SHORTER MATURITY WOULD ALLOW RATES TO MORE ACCURATELY REFLECT CURRENT MARKET CONDITIONS.)

5. COMMENT: IN FACE OF LARGE CASH BUDGET DEFICIT, ITALIAN MONETARY AUTHORITIES ARE SEEKING TO FINANCE DEFICIT THROUGH SOMEWHAT LESS INFLATIONARY MEANS THAN DIRECT ADVANCES FROM CENTRAL BANK. WHILE SEPTEMBER ISSUES OF NEW STYLE BOT'S WILL INITIALLY BE SUBSCRIBED BY BOI, IT WILL LATER BE DISPOSED OF IN MARKET AND OCTOBER ISSUE WILL BE ENTIRELY SOLD IN MARKET. EFFECT OF ISSUES WILL BE THAT TREASURY WILL BE OPENLY COMPETING WITH OTHER BORROWERS FOR AVAILABLE CREDIT, AS IS RECOGNIZED IN BANK CARTEL'S PLAN TO RAISE INTEREST CHARGED ON THEIR LOANS TO CLIENTS TO LEVELS COMPETITIVE WITH RISK-FREE YIELDS WHICH WILL BECOME AVAILABLE TO THEM THROUGH INVESTMENT IN NEW STYLE BOT ISSUES.

6. GOVERNMENT HAS TAKEN GREAT PAINS ONCE AGAIN TO ASSURE PUBLIC THAT IT DOES NOT INTEND TO IMPOSE TIGHT CREDIT CONDITIONS DURING PERIOD WHEN ECONOMIC RECOVERY IS JUST BUILDING UP STEAM. NEVERTHELESS, IT SEEMS CLEAR THAT GOI IS PREPARED TO RISK SOME RESTRAINING EFFECT ON GROWTH AS NECESSARY TO FIGHT INFLATION. (JULY INDUSTRIAL PRODUCTION INDEX FURTHER CONFIRMS RISING RATE OF ECONOMIC ACTIVITY WITH JULY 1972 TO JULY 1973 INCREASE OF 15.1 PERCENT AND SEVEN MONTH INCREASE OVER SAME PERIOD OF 1972 OF 6.2 PERCENT.)

7. LARGE BUDGET CASH DEFICIT PRESENTS DIFFICULT POLITICAL LIMITED OFFICIAL USE
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AND ECONOMIC PROBLEM FOR CENTER-LEFT GOVERNMENT. THERE SEEMS TO BE SOME FEELING THAT "PHASE ONE" OF ECONOMIC PROGRAM HAS NOW BEEN COMPLETED WITH VARIOUS CREDIT, BUDGET, EXCHANGE CONTROL AND PRICE FREEZE MEASURES TAKEN SINCE JUN-JULY. THEREFORE, PRESSURE IS INCREASING TO TURN TOWARD "PHASE TWO" PROBLEMS OF ECONOMIC AND SOCIAL REFORMS--MANY OF WHICH COST MONEY. FOR EXAMPLE, INCREASED FINANCING OF PROGRAM FOR DEVELOPMENT OF MEZZOGIORNO, FOR PENSIONS, AND FOR WAGE SETTLEMENT WITH RAILROAD WORKERS IMPLIES RISING BUDGETARY EXPENDITURES. TREASURY MINISTER LA MALFA, IN PARTICULAR, HAS TAKEN VERY STRONG STANCE AGAINST INCREASED BUDGET EXPENDITURES. HE REFUSED TO PARTICIPATE IN RECENT MEETING CONCERNING INCREASE IN WAGES OF ACTIVE RAILROAD WORKERS WHICH WOULD REPORTEDLY ADD ABOUT 390 BILLION LIRE TO BUDGET COSTS OVER 3 YEAR PERIOD. ALSO HE REPORTEDLY SENT LETTER TO PRIME MINISTER RUMOR URGING THAT CENTER-LEFT PARTIES ABIDE BY ECONOMIC POLICY COMMITMENTS MADE AT INCEPTION OF NEW GOVERNMENT. AT "SUMMIT MEETING" SEPTEMBER 18 OF HEADS OF CENTER-LEFT PARTIES WITH THREE ECONOMIC MINISTERS PROBLEMS VOICED BY LA MALFA WERE DISCUSSED AND

POSSIBLE NEED FOR INCREASED FISCAL REVENUES CONSIDERED.
GIVEN SIZE OF PRESENT AND PROJECTED BUDGET DEFICITS IT
IS DIFFICULT TO SEE HOW THEY CAN BE REDUCED BY EXPENDITURE
CUTS ALONE. ON OTHER HAND, TAX INCREASES WOULD NOT BE
EASY TO SELL, EITHER. VOLPE

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